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No. 91 - 571

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ROBERT J. TAYLOR, Trustee,

Petitioner,

v.

FREELAND & KRONZ, a Partnership; WENDELL G. FREELAND; and RICHARD F. KRONZ,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Curcuit

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BRIEF FOR PETTITIONER

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QUESTION PRESENTED

Whether, under Section 522(*l*) of the Bankruptcy Code, a bankruptcy court must exempt property from the bankruptcy estate, even though the debtor had no colorable basis for claiming the exemption, because no one objected to the claimed exemption within the period set forth in Bankruptcy Rule 4003(b).

PARTIES TO THE PROCEEDING

The parties to the proceedings in the court below were: Robert J. Taylor, as Trustee in the bankruptcy proceeding of Emily Davis; Freeland & Kronz, a partnership; Wendell G. Freeland; and Richard F. Kronz.

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OCTOBER TERM, 1991

No. 91-571

ROBERT J. TAYLOR, Trustee,

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v.

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**On Writ of Certiorari to the
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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit (Appendix to the

Petition for Certiorari ["Pet. App."], at 1a) is reported at 938 F.2d 420. The memorandum opinion of the United States District Court for the Western District of Pennsylvania (Pet. App. 18a) is reported at 118 Bankr. 272; its order affirming the judgment of the bankruptcy court is unreported (Pet. App. 16a). The memorandum opinion of the United States Bankruptcy Court for the Western District of Pennsylvania (Pet. App. 30a) is reported at 105 Bankr. 288; its judgment (Pet. App. 28a) is reported at 105 Bankr. 294.

JURISDICTION

The court of appeals entered its judgment on July 8, 1991. The Petition for a Writ of Certiorari was timely filed on October 7, 1991. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1)(1988).

STATUTES AND RULES INVOLVED

Section 105 of the Bankruptcy Code, 11 U.S.C. § 105 (1988), provides in pertinent part:

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Section 522 of the Bankruptcy Code, 11 U.S.C. § 522 (1988), provides in pertinent part:

(b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Bankruptcy Rules, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is --

> (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
>
> (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer

portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

* * *

(d) The following property may be exempted under subsection (b)(1) of this section:

(1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(2) The debtor's interest, not to exceed $1,200 in value, in one motor vehicle.

(3) The debtor's interest, not to exceed $200 in value in any particular item or $4,000 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $500 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(5) The debtor's aggregate interest in any property, not to exceed in value $400 plus up to $3,750 of any unused amount of the exemption provided under paragraph (1) of this subsection.

(6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

(7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.

(8) The debtor's aggregate interest, not to exceed in value $4,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.

(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

(10) The debtor's right to receive --

(A) a social security benefit, unemployment compensation, or a local public assistance benefit;

(B) a veteran's benefit;

(C) a disability, illness, or unemployment benefit;

(D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless --

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. 401(a), 403(a), 403(b), 408, or 409).

(11) The debtor's right to receive, or property that is traceable to --

(A) an award under a crime victim's reparation law;

(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed $7,500, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

* * *

(*l*) The debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section. If the debtor does not file such a list, a dependent of the debtor may file such a list, or may

claim property as exempt from property of the estate on behalf of the debtor. Unless a party in interest objects, the property claimed as exempt on such list is exempt.

Section 1621 of Title 18 of the United States Code, 18 U.S.C. § 1621 (1988), provides in pertinent part:

Whoever -

* * *

(2) In any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code, willfully subscribes as true any material matter which he does not believe to be true;

is guilty of perjury and shall, except as otherwise expressly provided by law, be fined not more than $2,000 or imprisoned not more than five years, or both. . . .

Rule 1007, Federal Rules of Bankruptcy Procedure, provides in pertinent part:

(c) Time Limits. The schedules and statements, other than the statement of intention, shall be filed with the petition in a voluntary case, if the petition is accompanied by a list of all the debtor's creditors and their addresses, within 15 days thereafter, except as otherwise provided in subdivisions(d), (e), and (h) of this rule. . . . Any extension of time for the filing of the schedules and statements may be granted only on motion for cause shown and on notice to the United

States trustee and to any committee elected pursuant to §705 or appointed pursuant to § 1102 of the Code, trustee, examiner, or other party as the court may direct. Notice of an extension shall be given to the United States trustee and to any committee, trustee, or other party as the court may direct.

Rule 1008, Federal Rules of Bankruptcy Procedure, provides:

All petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. § 1746.

Rule 1009, Federal Rules of Bankruptcy Procedure, provides in pertinent part:

(a) General Right to Amend. A voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed. The debtor shall give notice of the amendment to the trustee and to any entity affected thereby. On motion of a party in interest, after notice and hearing, the court may order any voluntary petition, list, schedule, or statement to be amended and the clerk shall give notice of the amendment to entities designated by the court.

Rule 4003, Federal Rules of Bankruptcy Procedure, provides in pertinent part:

(a) Claim of Exemptions. A debtor shall list the property claimed as exempt under § 522 of the Code on the schedule of assets required to be filed by Rule 1007. If the debtor fails to claim exemptions or file

the schedule within the time specified in Rule 1007, a dependent of the debtor may file the list within 30 days thereafter.

(b) Objections to Claim of Exemptions. The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court. Copies of the objections shall be delivered or mailed to the trustee and to the person filing the list and the attorney for such person.[1]

(c) Burden of Proof. In any hearing under this rule, the objecting party has the burden of proving that the exemptions are not properly claimed. After hearing on notice, the court shall determine the issues presented by the objections. . . .

Rule 9011, Federal Rules of Bankruptcy Procedure, provides in pertinent part:

(a) Signature. Every petition, pleading, motion and other paper served or filed in a case under the Code on behalf of a party represented by an attorney, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name, whose office

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[1]The phrase "or supplemental schedules" was added to subsection (b) by the amendments to the Bankruptcy Rules, effective August 1, 1991.

address and telephone number shall be stated. A party who is not represented by an attorney shall sign all papers and state the party's address and telephone number. The signature of an attorney or a party constitutes a certificate that the attorney or party has read the document; that to the best of the attorney's or party's knowledge, information, and belief formed after reasonable inquiry it is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation or administration of the case. If a document is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the person whose signature is required. If a document is signed in violation of this rule, the court on motion or on its own initiative, shall impose on the person who signed it, the represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the document, including a reasonable attorney's fee.

STATEMENT OF FACTS

This case presents the question of whether, under Section 522(*l*) of the Bankruptcy Code, 11 U.S.C. § 522(*l*), a debtor may obtain an exemption for certain property, even though there was no colorable legal basis for claiming such an exemption, because no one filed a formal objection to the claimed exemption within the 30-day period set forth in Bankruptcy Rule 4003(b).

The exemption at issue in this case was claimed by Emily Davis ("Davis") concerning the proceeds of a lawsuit for employment discrimination that she had filed against Trans World Airlines ("TWA"). In April of 1978, Davis filed a Complaint with the Pittsburgh Commission on Human Relations ("Commission"), alleging that TWA had discriminated against her by denying her promotions on the basis of her race and sex.[2]

On December 16, 1980, the Commission entered an Order directing TWA to pay Davis "lost wages representing the difference between her salary as a Reservations Sales Representative and the salary of a Senior Sales Representative, the position she was denied because of unlawful discrimination from the period March, 1976 until the date TWA no longer employed Senior Sales Representatives in its Pittsburgh office." Joint Appendix (hereinafter "Jt. App."), at 3. The Commission characterized its award as a "back pay" award. Appendix filed with the Third Circuit (hereinafter "App."), at 102. The actual amount of the award was to be determined after TWA had provided the Commission with the necessary information about Davis' wages and the wages of Senior Sales Representatives in the Pittsburgh area. Jt. App. 4.

TWA appealed the Commission's decision to the Court of Common Pleas of Allegheny County. On September 23, 1981, the Court of Common Pleas reversed the Commission's decision and held that

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[2]Brief for Appellants, at 6-7, *Taylor v. Freeland & Kronz*, No. 90-3693 (3d Cir. July 8, 1991) (hereinafter "Brief").

TWA was not liable to Davis. App. 111. Davis in turn appealed to the Commonwealth Court of Pennsylvania, which, on June 27, 1983, reversed the judgment of the Court of Common Pleas and reinstated the Commission's award. App. 125. TWA then filed a petition for Allowance of Appeal with the Supreme Court of Pennsylvania, which on November 18, 1983, agreed to hear the appeal. App. 294.

On October 24, 1984, after the appeal had been briefed and argued in the Supreme Court of Pennsylvania, but before that court had issued its decision, Davis filed a voluntary petition under Chapter 7 of the Bankruptcy Code. Jt. App. 55. On the schedules which she filed with her bankruptcy petition, Davis claimed an exemption, under 11 U.S.C. § 522(d), for:

> Proceeds from lawsuit - Winn v. TWA
> Claim for lost wages

Jt. App. 18.[3] Section 522(d) does not exempt claims for past wages as such from the bankruptcy estate. *See* pp. 31-33, *infra*.

On the portion of the form in which she was to state the "value" of those proceeds, she indicated that the value was "unknown." Jt. App. 18. However, it appears that she and her attorneys expected to recover

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[3]Section 522(b), which Davis also cited as a basis for the claimed exemption, simply provides that a debtor may select either the federal exemptions listed in Section 522(d) or, alternatively, exemptions which are available under state or other law. 11 U.S.C. § 522(b).

approximately $100,000 if the Commission's decision was upheld by the Pennsylvania Supreme Court.[4] It also appears that she and her attorneys expected that as much as $70,000 of the expected recovery would constitute compensation for lost pre-petition earnings.[5]

Section 522(b) of the Bankruptcy Code, 11 U.S.C. § 522(b), provides that "an individual debtor may exempt from property of the estate" either the types of property listed in 11 U.S.C. § 522(d) or, in the alternative, property which is exempt under other legal provisions (including state and local law). The procedure for claiming these exemptions is set forth in 11 U.S.C. § 522(*l*), which requires the debtor (or a dependent of the debtor) to "file a list of property that the debtor claims as exempt under" 11 U.S.C. § 522(b).[6] Under Bankruptcy Rule 4003(b), "[t]he trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the

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[4]As is more fully discussed below, p. 15, either Davis or the attorney representing her in the bankruptcy proceeding estimated, on January 4, 1985, that the lawsuit was worth $90,000. Jt. App. 26. And one of the attorneys representing her in the TWA lawsuit estimated, on January 9, 1985, that the lawsuit was worth $110,000. Jt. App. 28.

[5]The attorneys representing Davis in the TWA lawsuit prepared an estimate of her damages, in 1987, which indicated a wage loss of approximately $70,000 (without interest) through 1984. Jt. App. 31.

[6]Specifically, "[a] debtor shall list the property claimed as exempt under § 522 of the Code on the schedule of assets required to be filed by Rule 1007." Bankruptcy Rule 4003(a).

conclusion of the meeting of creditors held pursuant to [Bankruptcy] Rule 2003(a). . . ." The bankruptcy court then determines whether the claimed exemptions are valid, and if they are, the property at issue is removed from the bankruptcy estate.

On November 26, 1984, Petitioner Robert Taylor ("Taylor") was appointed trustee in the bankruptcy proceeding. App. 41. Three days later, on November 29, 1984, the Supreme Court of Pennsylvania ruled in Davis' favor by affirming the judgment of the Commonwealth Court. App. 128.

On January 4, 1985, Taylor conducted the meeting of the creditors held pursuant to Bankruptcy Rule 2003(a). Jt. App. 25. Neither Taylor nor any of the creditors filed any objections, within the 30-day period specified by Rule 4003(b), to the exemptions claimed by Davis. Although Taylor considered the proceeds from the TWA lawsuit (less "costs and attorney fees") to be the property of the estate, he wanted to find out, before making any formal objections to the claimed exemptions, how much money (if any) Davis would actually recover from that lawsuit. App. 227, 230, 234-235.[7] Nonetheless, in his letter of January 7, 1985 to respondents Wendell G. Freeland ("Freeland") and Richard F. Kronz ("Kronz"), Taylor advised them of his position that "the net proceeds of said suit would be an asset in the bankruptcy estate." He also asked about the status of the litigation. Jt. App. 27. In a letter dated January 9,

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[7]Either Davis or her bankruptcy counsel had advised him that Davis could recover as much as $90,000 from the TWA lawsuit. Jt. App. 55, 26; App. 232-233.

1985, an associate of Freeland & Kronz responded by informing Taylor that the Pennsylvania Supreme Court had ruled in Davis' favor and that Freeland & Kronz had calculated the damages (which had not yet been judicially determined) at $110,000. Jt. App. 28.

The bankruptcy case was never closed, although Davis was discharged on October 16, 1985. Jt. App. 56. On March 25, 1985, the Supreme Court of Pennsylvania agreed to let TWA reargue its appeal of the Commission's award, but on October 1, 1986, the Supreme Court held that reargument of the appeal had been improvidently granted and dismissed TWA's appeal. App. 141.

At this point, Davis and TWA were now ready to proceed with a hearing on damages before the Commission, and such a hearing was tentatively scheduled for July 9, 1987. App. 344. However, that hearing was never held, because the parties settled the case. *Id.*

On September 11, 1987, Davis executed a settlement agreement with TWA under which TWA was to pay her and her attorneys approximately $110,000, including $23,483.75 (less applicable withholding taxes) "as and for back pay or front pay," $23,483.75 "as and for all alleged tort claims or any other claims not represented [sic] asserted wage losses," and $63,032.50 "as and for attorney's fees and expenses . . . ." Jt. App. 42. Neither Davis nor her attorneys informed Taylor of the settlement until May of 1988, after Taylor had written to Freeland & Kronz requesting information on the status of the lawsuit. App. 48, 75.

In October, 1988, Taylor filed a complaint against Davis, Freeland & Kronz, Freeland, and Kronz seeking to recover for the bankruptcy estate $79,016.25 which had been paid as part of the TWA settlement. App. 8-17. The Bankruptcy Court ordered that the defendants return to Taylor the $23,483.75 paid as recovery for tort claims (plus interest), on the grounds that there was "no statutory basis" under 11 U.S.C. § 522(d) for exempting a tort recovery. Pet. App. 40a-41a.[8] It rejected, on the grounds of judicial estoppel, the defendants' assertion that the sum in question actually represented lost future wages, which would be exempt under the Bankruptcy Code,[9] but had been described as being for tort claims in order to avoid paying taxes on it. Pet. App. 41a-42a. It also held that while neither Taylor nor any of the creditors had filed an objection to the claimed exemption within the period specified by Bankruptcy Rule 4003(b) (within 30 days after the meeting of creditors), Section 522(*l*) implicitly requires that "there be a statutory basis for the claimed exemption before the failure of any party in interest to timely object to it has any legal effect". Pet. App. 38a.

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[8]The bankruptcy court concluded that requiring the defendants to return $23,483.75 would "produce a *res* sufficient to pay all of Debtor's [Davis'] creditors" and that it was therefore "not necessary . . . to determine whether" there was any statutory basis under Section 522(d) for exempting the remaining portions of the TWA settlement. Pet. App. 42a.

[9]Section 522 exempts "a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." 11 U.S.C. § 522(d)(11)(E).

The Bankruptcy Court reasoned that Section 522(*l*) incorporates by reference the provisions of Section 522(b), which limits exemptions to those available under federal, state, or local law, and that "[i]f Debtor may select in any manner her exemptions, then no purpose is served by the inclusion of" Section 522(b). *Id.* The Bankruptcy Court also noted that permitting "exemption by declaration" would "encourage certain debtors of questionable integrity to claim *all* of their property as exempt," in the hope that the trustee would fail to object, and that "constant litigation, if not outright chaos, would result." Pet. App. 38a-39a. (emphasis in original) It concluded that "this surely would not be the congressional intent." *Id.*

The District Court affirmed the Bankruptcy Court's decision. It agreed that the doctrine of judicial estoppel was applicable and that "there was no statutory basis for claiming as exempt that part of the lawsuit's proceeds which represented recovery for tort claims." Pet. App. 24a-26a. It also agreed that Section 522(*l*) requires "that there be a statutory basis for a claimed exemption before the failure of any person in interest to timely object to it has any legal effect." Pet. App. 24a. In reaching that conclusion, it reasoned that (1) "[a]llowing the debtor to recover proceeds for which there was no statutory basis would render § 522(b) nugatory" and (2) "the orderly administration of the debtor's estate would not be advanced by allowing her to claim as exempt any value which she had simply designated 'unknown.'" *Id.*

The Third Circuit, however, reversed, and held that the failure of the trustee (or any other party in

interest) to file a formal objection to the claimed exemption within the period specified by Bankruptcy Rule 4003(b) meant that the proceeds of the TWA settlement were exempt under Section 522(*l*). Pet. App. 9a. The Court of Appeals acknowledged that a number of courts, including the Sixth and Eighth Circuits, had ruled that where no one has objected in a timely manner to a claimed exemption, courts are not to fully examine the validity of the exemption, but must still deny the exemption if there was no "good-faith statutory basis" for claiming it. Pet. App. 8a. The Court of Appeals also acknowledged that some courts have gone even further, and held that courts must deny an "invalid" exemption, whether or not anyone objected to it in a timely manner. Pet. App. 7a. But the Court of Appeals rejected both of those approaches and adopted what it characterized as "the 'literal' approach. . . ." *Id.*

In reaching its result, the Third Circuit reasoned that (1) the text of Section 522(*l*) and Bankruptcy Rule 4003(b) "admits of no exceptions to the bright-line procedural rule," (2) that "[n]othing in the legislative materials suggests that any exceptions to this bright-line rule were intended," (3) that "the evolution of the bankruptcy laws suggests that Congress intended to shift the burden of objection from the debtor to the other parties in interest," and (4) that, as a matter of policy, "[t]he time limits and obligations established by section 522(*l*) and Rule 4003(b) serve the dual purposes of finality and certainty." Pet. App. 11a-12a. It also argued that its approach would not, as some courts have feared, "lead to a system of 'exemption by declaration'. . . ," because Bankruptcy Rule 9011 "authorizes sanctions" for

bad-faith exemption claims and "should act as the primary deterrent" against such claims. Pet. App. 13a-14a.

SUMMARY OF ARGUMENT

The court below erred in concluding that Section 522(*l*) of the Bankruptcy Code and Bankruptcy Rule 4003(b) prevent bankruptcy courts from disallowing a claimed exemption when the debtor had no colorable basis for claiming the exemption.

The court below did not discuss or even mention the 1986 amendment to Section 105(a) of the Bankruptcy Code, which requires that Section 522(*l*) be read to permit the denial of exemption claims that constitute an "abuse of process." Section 105(a) provides that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate . . . to prevent an abuse of process." Although Congress has not specifically defined the term "abuse of process" in the Bankruptcy Code, it is clear that the amendment clarifies the power of bankruptcy courts to disallow frivolous claims, even when parties in interest have not raised objections to such claims within the time periods set forth in the Code and the Bankruptcy Rules.

This Court has held that making objectively unreasonable claims constitutes an "abuse of the judicial process," and a number of lower federal courts have confirmed that Section 105(a) requires that Section 522(*l*) be read to permit denial of frivolous

exemption claims even where there has been no timely objection. Finally, insofar as the Bankruptcy Rules permit debtors to amend their claimed exemptions as a matter of course at any time before the case is closed, a rigid interpretation of Section 522(*l*) and Bankruptcy Rule 4003(b) would create significant and unwarranted differences between the treatment of debtors and creditors under the congressional scheme.

Even the court below acknowledged that without some sort of "safeguards," its interpretation of Section 522(*l*) and Rule 4003(b) would encourage debtors to make frivolous exemption claims in the hope that harried trustees might neglect to file timely objections. However, the court erroneously believed that such a safeguard was provided by Bankruptcy Rule 9011 (which is analogous to Fed. R. Civ. P. 11). In fact, Rule 9011 does not apply to exemption claims filed in schedules to the bankruptcy petition. Therefore, were one to ignore Section 105(a) and construe Section 522(*l*) in the manner suggested by the court below, bankruptcy courts would be powerless to discourage frivolous and abusive exemption claims: hardly the result that Congress intended.

In the present case, it is clear that the debtor lacked even a colorable basis for claiming that portion of the exemption which was disallowed by the Bankruptcy Court. She claimed the entire proceeds of a discrimination lawsuit as exempt, even though it was clear that there were no "federal" exemptions, under Section 522(d), for a substantial portion of that award. Consequently, the Bankruptcy Court was justified in disallowing that portion of the claimed exemption, and had the power to do so, under Section 522(*l*) of the

Code, even though no party in interest had filed a formal objection within the thirty-day period specified in Bankruptcy Rule 4003(b).

ARGUMENT

I. IN LIGHT OF SECTION 105(a) OF THE BANKRUPTCY CODE, THE TIME LIMITS OF SECTION 522(*l*) CANNOT BE CONSTRUED TO PROTECT BAD FAITH EXEMPTION CLAIMS

Section 522(*l*) of the Bankruptcy Code, 11 U.S.C. § 522(*l*), requires that "[t]he debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section." It also provides that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt . . . ." Bankruptcy Rule 4003(b) establishes a thirty-day time limit for objecting to exemptions claimed by the debtor. Construing Section 522(*l*) in conjunction with Bankruptcy Rule 4003(b), the court below concluded that "[u]nless the trustee or another party in interest objects to the debtor's claimed exemptions within the thirty-day period following the creditors' meeting or the amendment, the property claimed as exempt by the debtor is exempt." Pet. App. 6a.

Many lower federal courts, including three Courts of Appeals, have disagreed. Some courts have gone so far as to hold that they may fully examine the merits of any claimed exemption, and deny the exemption if they deem it "invalid," regardless of whether anyone

filed an objection within the thirty-day period.[10] Courts which have construed Section 522(*l*) in this manner have generally concluded (1) that Section 522(*l*) incorporates by reference the provisions of Section 522(b), which strictly limits the exemptions that a debtor may claim; and (2) that to permit "exemption by declaration," whenever the trustee and the creditors neglect to file a timely objection, would encourage debtors to make invalid claims and result in a flood of unnecessary litigation.

A more moderate, "middle-ground" approach, which petitioner believes to be the correct one, has been endorsed by a number of federal courts, including the Courts of Appeals for the Fifth, Sixth, and Eighth Circuits. Under this interpretation of Section 522(*l*), courts are *not* to fully examine the merits of a claimed exemption if no party in interest has objected within the thirty-day period. They are only to determine whether there is a "good faith" (i.e., reasonably disputable) basis for claiming the exemption. If the debtor had a colorable basis for claiming the exemption, then the court must allow it, even if the court believes that the debtor is wrong. On the other hand, if the claim is clearly unreasonable, and there was not even a colorable basis for claiming the exemption, then the court may

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[10] *See, e.g., In re Staniforth*, 116 Bankr. 127, 131 (Bankr. W.D. Wis. 1990); *In re Velis*, 109 Bankr. 64, 65 (Bankr. D. N.J. 1989), *aff'd*, 123 Bankr. 497 (D. N.J. 1991); *In re Ehr*, 116 Bankr. 665, 668 (Bankr. E.D. Wis. 1988); *In re Rollins*, 63 Bankr. 780, 783-784 (Bankr. E.D. Tenn. 1986); *In re Bennett*, 36 Bankr. 893, 895 (Bankr. W.D. Ky. 1984); *Hackett v. Commercial Banking Corp. (In re Hackett)*, 13 Bankr. 755, 757 (Bankr. E.D. Pa. 1981).

disallow the exemption.[11] This approach gives effect to Section 522(*l*) by holding that in the absence of a timely objection, the bankruptcy court must allow all exemptions whose validity is reasonably disputable, even if the court believes those exemptions to be invalid. At the same time, this approach prevents "exemption by declaration" and will discourage debtors from filing frivolous exemption claims in the hope that a harried trustee may neglect to file a timely objection.

This "good faith" approach to Section 522(*l*) is clearly mandated by Section 105(a) of the Bankruptcy Code, which the court below did not mention in its opinion. Section 105(a) provides that:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. *No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate* to enforce or implement court orders or rules, or *to prevent an abuse of process.*

11 U.S.C. § 105(a) (emphasis added). Thus, even though Section 522(*l*) requires a "party in interest" to

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[11] *See, e.g., Halverson v. Peterson* (*In re Peterson*), 920 F.2d 1389, 1393-1394 (8th Cir. 1990); *Munoz v. Dembs* (*In re Dembs*), 757 F.2d 777, 780 (6th Cir. 1985); *Sherk v. Texas Bankers Life & Loan Ins. Co.* (*In re Sherk*), 918 F.2d 1170, 1174 (5th Cir. 1990); *In re Kingsbury*, 124 Bankr. 146, 148 (Bankr. D. Me. 1991); *Clark v. Kazi* (*In re Kazi*), 125 Bankr. 981, 990 (Bankr. S.D. Ill. 1991).

raise the "issue" of whether a claimed exemption is proper, bankruptcy courts may disallow such exemptions in order "to prevent an abuse of process."

The second sentence of Section 105(a), which authorizes bankruptcy courts to prevent an "abuse of process," was added to Section 105(a) by Section 203 of the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. 99-554, 100 Stat. 3088, 3097 (1986). The amendment is clearly applicable to this case, because Section 302(d) of the Act -- which governs, *inter alia*, "[t]he judicial districts established for the State of Pennsylvania" -- provides that the amendments which the Act makes to Section 105 shall become applicable "to cases while pending in such district" no later than 270 days after the effective date of the Act (November 26, 1986). 100 Stat. 3120. Taylor filed his complaint in this case in October, 1988 (App. 4-5), and the Bankruptcy Court issued its order disallowing a portion of the exemption claimed by Davis on September 7, 1989. Pet. App. 28a-29a.

The term "abuse of process" is not defined either in Section 105(a) or elsewhere in the Bankruptcy Code. However, the legislative history of the amendment to Section 105(a), while sparse, suggests that Congress wished to clarify the broad powers of bankruptcy courts to protect the integrity and effectiveness of the bankruptcy process. In June, 1985, the House of Representatives submitted H.R. 2211, 99th Cong., 1st. Sess (1985), to the Senate, which added the second sentence of Section 105(a) pursuant to a floor amendment introduced by Senator Thurmond. The text of H.R. 2211, as amended by the

Senate, was later substituted for the text of H.R. 5316, 99th Cong., 2d Sess (1986), and, in that form, became the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986. In the course of that process, Senator Hatch noted that "[t]his bill allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner." 132 Cong. Rec. 28610 (daily ed. Oct. 3, 1986).

This Court has made clear that the making of objectively unreasonable claims constitutes an abuse of the judicial process. For example, Fed. R. Civ. P. 11 requires that "[p]leading[s], motion[s], and other paper[s] . . . [be] warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law . . . " The standard is one of objective reasonableness, and "the relevant inquiry is whether a specific filing was, if not successful, at least well founded." *Business Guides, Inc. v. Chromatic Communications Enterprises, Inc.*, 111 S.Ct. 922, 934 (1991). In *Cooter & Gell v. Hartmarx Corp.*, 110 S.Ct. 2447, 2456 (1990), the Court characterized the filing of papers which violate the Rule 11 standard as an "abus[e of] the judicial process," holding that "the imposition of a Rule 11 sanction . . . requires the determination of a collateral issue: whether the attorney has *abused the judicial process*, and, if so, what sanction would be appropriate." (Emphasis added). *Accord*, *Business Guides*, 111 S.Ct. at 928-29. Consequently, when a debtor claims an exemption for which there is no colorable legal basis, such conduct constitutes an "abuse" of the bankruptcy process which the bankruptcy court may prevent by disallowing the

claimed exemption. Indeed, a number of lower federal courts have specifically relied upon Section 105(a) in holding that bankruptcy courts may disallow frivolous exemption claims even when no one has objected to such claims within the periods prescribed by Bankruptcy Rule 4003(b) or by local rule. *See, e.g., Ragsdale v. Genesco, Inc.*, 674 F.2d 277, 278 (4th Cir. 1982) (holding that where a local bankruptcy rule required that any objection to claimed exemptions be made within 15 days, and no one objected within the 15-day period, Section 105(a) nonetheless gave the bankruptcy court the authority to deny the claimed exemption); *In re Staniforth*, 116 Bankr. 127, 131 (Bankr. W.D. Wis. 1990) (holding that where the trustee failed to object to a claimed exemption within the thirty-day period prescribed by Bankruptcy Rule 4003(b), the bankruptcy court may still inquire into the merits of the claimed exemption because under Section 105, "the Bankruptcy Court may take any action to prevent an abuse of process"); *In re Budinsky*, 1991 WL 105640, at *2 (W.D. Pa. 1991) (WESTLAW, Allfeds) (holding that even where the parties in interest have failed to object to a claimed exemption, Section 105 authorizes the bankruptcy court to "strike improperly claimed exemptions, sua sponte" in order "to enforce the Bankruptcy Code and prevent any abuse of process").

Moreover, to construe Section 522(*l*) in the manner suggested by the court below would create manifest inequities between the treatment of debtors and creditors under the Bankruptcy Rules. Under Bankruptcy Rules 4003(a) and 1007(c), a debtor must file a list of exempt property on its schedule of assets, and (in a voluntary case) the schedule of assets must

be filed within 15 days after the filing of the petition. The Bankruptcy Rules allow great latitude to the debtor in amending those schedules while the bankruptcy proceeding is pending. Bankruptcy Rule 1009(a) provides that the debtor may amend its schedule of assets "as a matter of course at any time before the case is closed." While the Bankruptcy Rules were obviously designed to impose stricter limits on the creditors than on the debtor, construing Section 522(*l*) and Bankruptcy Rule 4003(a) to impose an absolutely rigid rule as to objections would, under these circumstances, be anomalous.

Even the court below acknowledged the importance of "safeguards" which "ensure that debtors have little or no incentive to claim all of their property as exempt." Pet. App. 14a. The court below suggested that "the primary deterrent against debtors engaging in bad faith exemption claims" is Bankruptcy Rule 9011, "which is analogous to Rule 11 of the Civil Rules . . . " and which supposedly "forbids bad faith exemption claims and authorizes sanctions for violation of this prohibition." *Id.*

However, Bankruptcy Rule 9011 does *not* authorize sanctions for groundless or "bad faith" exemption claims and cannot be, as the court below suggested, "the primary deterrent" against making such claims. Pet. App. 14a. Under the Bankruptcy Rules, a debtor claims exemptions by listing them "on the schedule of assets required to be filed by Rule 1007." Bankruptcy Rule 4003(a). But Bankruptcy Rule 9011(a), which requires that certain documents be signed, and authorizes sanctions when the document is not "warranted by existing law or a good faith

argument for . . . [altering] existing law," is by its own terms not applicable to "list[s], *schedule[s]*, or statement[s], or amendments thereto . . . " Bankruptcy Rule 9011(a) (emphasis added). *See also In re Muscatell*, 116 Bankr. 295, 298 (Bankr. M.D. Fla. 1990); *In re Alderson*, 114 Bankr. 672, 677 (Bankr. D. S.D. 1990).[12]

Accordingly, as a practical matter, construing Section 522(*l*) as the court below did *would* encourage debtors "to claim all property as exempt in the hope that no party in interest would object." It is undoubtedly for just such reasons that Congress enacted Section 105(a), which permits bankruptcy courts to prevent such abuses of the judicial process. When Section 522(*l*) is construed in the manner required by Section 105(a), it becomes clear that the approach adopted by the Fifth, Sixth, and Eighth Circuits is the correct one. Even if no party in interest has objected to a claimed exemption within the thirty-day period prescribed by Bankruptcy Rule 4003(b), a bankruptcy court may disallow the claimed

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[12]It is true that under Bankruptcy Rule 1008, "[a]ll petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 USC § 1746," which requires the declarant to state "under penalty of perjury" that the contents of the document are "true and correct." 28 U.S.C. § 1746 (1988). But rarely, if ever, would a debtor be guilty of "perjury" for claiming a legally groundless exemption. One is only guilty of "perjury" under 18 U.S.C. § 1621 if he or she "willfully subscribes as true any material matter which he does not believe to be true." 18 U.S.C. § 1621(2) (1988). Yet one might easily make a legally groundless claim without "willfully" lying about material facts.

exemption if there was no colorable legal basis for claiming it.

II. DAVIS CLEARLY HAD NO COLORABLE STATUTORY BASIS FOR CLAIMING THE ENTIRE PROCEEDS OF THE TWA LAWSUIT AS EXEMPT, AND THUS THE BANKRUPTCY COURT WAS JUSTIFIED IN DENYING A PORTION OF THE CLAIMED EXEMPTION

Under the Bankruptcy Code, Taylor was entitled to select either the federal exemptions listed in Section 522(d) or, alternatively, exemptions which were available under state or other law. 11 U.S.C. § 522(b). When Davis filed her bankruptcy schedules on October 24, 1984, she elected to claim the federal exemptions listed in Section 522(d) and claimed an exemption for the entire proceeds of her lawsuit against TWA. Jt. App. 17-18. Specifically, she claimed an exemption for "[p]roceeds from lawsuit - Winn v. TWA / Claim for lost wages." *Id.* at 18. However, it was clear when she filed her schedules that only a limited portion of the proceeds recovered could be exempted under Section 522(d).

The claim in question was filed with the Pittsburgh Commission on Human Relations ("Commission") in April, 1978. On December 16, 1980, the Commission awarded Davis "lost wages representing the difference between her salary as a Reservations Sales Representative and the salary of a Senior Sales Representative, the position she was denied because of unlawful discrimination from the period March, 1976 until the date TWA no longer employed Senior Sales Representatives in its

Pittsburgh office [1980]."[13] Jt. App. 3. The Commission characterized its award as a "back pay" award.[14] The amount of this award for back pay was at that time undetermined, but was estimated in the approximate amount of $11,000 (without interest).[15] TWA appealed the Commission's decision to the Allegheny County Court of Common Pleas, which, on September 23, 1981, reversed the Commission's decision and held that TWA was not liable to Davis. App. 111. However, on June 27, 1983, the Pennsylvania Commonwealth Court reinstated the Commission's award, again characterizing it as an award for "back pay." App. 115, 125.

There is no basis under Section 522(d) for exempting "back pay" awards except to the extent that the award qualifies for the catch-all exemption for "any property" in Section 522(d)(5) which was

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[13]As respondents have conceded in their Third Circuit brief, "[i]t was . . . uncontroverted at trial that TWA no longer employed Senior Sales Representatives in Pittsburgh after 1980." Brief, at 19.

[14]*See* App. 102 (noting that no additional "back pay" would be awarded for TWA's conduct in refusing to promote Davis to the Team Coordinator or Cargo Account Executive positions).

[15]In the estimate of Davis' damages which the respondents prepared in May, 1987, they calculated her lost earnings for the period 1976-1980 at $11,223 (not including interest). Jt. App. 31. *See also* Brief, at 19 (stating that "if the Commission did not change it's [sic] position on damages, the maximum Miss Davis would be entitled to would be $11,219 (wage losses from March, 1976 through 1980)").

available to Taylor in the amount of $3,950.[16] There was thus no basis for claiming an exemption for the Commission's entire original award. Moreover, when on October 24, 1984, Davis filed her bankruptcy petition and her claim of exemption, she apparently viewed her Commission claim as then having a value in the area of $100,000 -- far in excess of the $11,000 claimed for back pay through 1980.[17] The two additional components of that claim were for (1) additional back pay between the date of the Commission's award (December 16, 1980) and the date on which Davis filed her bankruptcy petition (October 24, 1984) -- which was later claimed to be in excess of $60,000 [18] and (2) for lost wages which might accrue after the filing of the petition (front pay).

While the front pay (post-petition) portion of such excess recovery would have been exempt as "payment

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[16]Section 522(d)(5) provides an exemption in the total amount of $4,150. As respondents have conceded, Davis used $200 of this exemption elsewhere, and thus would be entitled to exempt only $3,950 of the lawsuit proceeds under Section 522(d)(5). Brief, at 30.

[17]This amount would have been increased by the inclusion of interest. Either Davis or the attorney representing her in the bankruptcy proceeding estimated, on January 4, 1985, that the lawsuit was worth $90,000. Jt. App. 26; App. 232-233. And an associate with respondents' firm, who was representing her in the TWA lawsuit, estimated, in a letter dated January 9, 1985, that the lawsuit was worth $110,000. Jt. App. 28.

[18]In the estimate of Davis' damages which respondents submitted to TWA in May of 1987, they calculated lost wages for the period 1981-1984 at $61,823 (without interest) and $78,723 (with interest). Jt. App. 31.

in compensation of loss of future earnings of the debtor . . . ," 11 U.S.C. § 522(d)(11)(E), the additional back pay component was, of course, not exempt.

Consequently, when Davis filed her bankruptcy petition in 1984, she must have been aware that the Commission's award was for back pay, which was not exempt as such, and that the back pay component of any further award also was not exempt. Yet she claimed the entire award as exempt. There is no basis for respondents' contention that the exemption was claimed in good faith.

Respondents argue that after the date of the claimed exemptions Taylor entered into a settlement with TWA, and that the amounts paid in settlement were exempt. If the original claim of exemption were read in the light of this subsequent history, as the lower courts appeared to do,[19] there was still no basis for claiming the entire claim as exempt.

The settlement was reached almost three years after Davis filed her bankruptcy petition, and before the Commission had held any hearings on damages. TWA agreed to settle all claims which Davis might have against it for a total of approximately $110,000. Jt. App. 41-42. According to the recitations contained in the settlement agreement, $23,483.75 (less applicable withholding taxes) was paid to Davis "as and for back pay or front pay" and $23,483.75 "as and

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[19] *See* Pet. App. 25a-27a, 41a-42a.

for all alleged tort claims or any other claims not represented [sic] asserted wage losses."[20]

The only portion of such an award that could be exempt under the Code would be the portion qualifying for the "any property" exemption ($3,950) and the portion attributable to lost post-petition wages, or "front pay." There is no exemption either for back pay or tort claims.[21] Thus, even if one were to assume that Davis envisioned such a settlement when she filed her bankruptcy schedules, the fact remains that Davis had no colorable grounds for exempting either the "back pay" or "tort claims" portions of the settlement (except for the $3,950 which she was entitled to exempt under Section 522(d)(5)). The Bankruptcy Court therefore had the authority, under Sections 105 and 522(*l*) of the Bankruptcy Code, to deny an exemption for $23,483.75 of the

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[20]Jt. App. 42. In addition, $63,032.50 of the settlement was characterized as being "as and for attorneys' fees and expenses in connection with the above-recited case . . . ." *Id.* The courts below did not determine whether this last portion of the settlement was property of the estate (or, as such, exempt), because, as the Bankruptcy Court pointed out, "[r]equiring Defendants to return the $23,483.75 portion of the settlement for averred tort losses will produce a *res* sufficient to pay all of Debtor's creditors, with interest . . . ." Pet. App. 42a.

[21]Contrary to respondents' contention (Brief, at 32), the "tort claims" portion of the settlement was not paid to compensate Davis for lost pension benefits and thus was not exemptible under 11 U.S.C. § 522(d)(10)(E). First, the District Court found that this portion of the settlement was not paid for pension benefits. Pet. App. 26a n.3. Second, Davis, in her bankruptcy schedules, characterized this as a "claim for lost wages." Jt. App. 18.

settlement proceeds, because by doing so it prevented an abuse of the bankruptcy process.[22]

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[22]Indeed, the Bankruptcy Court was, if anything, overly generous to Davis in denying only the $23,483.75 exemption claimed for "tort claims." Davis was not entitled either to exempt the "tort claims" portion of the settlement *or* the portion of the settlement which was for "back pay."

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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